

**ST 04-10**

**Tax Type: Sales Tax**

**Issue: Exemption From Tax (Charitable or Other Exempt Types)**

**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
SPRINGFIELD, ILLINOIS**

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**ABC BUILDING CORP.  
Taxpayer**

**v.**

**THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS**

**Docket # 02-ST-0000**

**Denial of Sales Tax Exemption**

**Barbara S. Rowe  
Administrative Law Judge**

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Mr. Barry O. Hines, Barber, Segatto, Hoffee & Hines for ABC Building Corporation; Mr. Kent R. Steinkamp, Special Assistant Attorney General for the Illinois Department of Revenue.

**Synopsis:**

ABC Building Corporation sought an exemption from the application of tax under the Illinois Retailers' Occupation Tax Act (35 **ILCS** 120/1 *et seq.*) (hereinafter the "ROTA" or the "ROT") as an entity organized and operated exclusively for charitable or religious purposes pursuant to 35 **ILCS** 120/2-5 (11); in the alternative that the sales are exempt as sales of personal property sold to a lessor who leases the property to a governmental body for at least one year under 35 **ILCS** 120/2-5(29); or a combination of the two arguments pursuant to 86 Ill. Admin. Code §130.2075.

The Illinois Department of Revenue issued a denial of a sales tax exemption letter and a tax exemption identification number to ABC Building Corporation (hereinafter "Taxpayer,"

“Lessor,” or “ABC”). Taxpayer timely protested the denial and asked for a hearing. The parties requested that the matter be heard on the stipulation of facts with attached exhibits, arguments, and briefs submitted. It is recommended that the requested exemption letter and number be denied.

**FINDINGS OF FACT:**

Stipulations<sup>1</sup>

1. The Taxpayer, ABC Building Corp., is an Illinois not for profit corporation in good standing, with a 501(c)(2) tax exempt<sup>2</sup> organization status determined by the Internal Revenue Service. (Joint Ex. No. 1 ¶1)

2. The Taxpayer’s articles of incorporation provide that it is organized “to assist in developing and increasing the facilities, programs and services of The First Presbyterian Church of Anywhere, Illinois, a religious corporation, for its religious purpose.” (Joint Ex. No. 1 ¶2)

3. The Taxpayer’s Bylaws provide that all Directors must at all times be members in good standing of the First Presbyterian Church of Anywhere, Illinois, or, in the case of the minister, its then acting head minister. The Bylaws provide that the right to alter, amend or repeal the Bylaws or adopt new Bylaws is held by the Board of Directors. (Joint Ex. No. 1 ¶3)

4. The Taxpayer’s sole member is The First Presbyterian Church of Anywhere, Illinois. (Joint Ex. No. 1 ¶4)

5. The Illinois Department of Revenue has issued a sales tax exemption letter to the First Presbyterian Church of Anywhere, Illinois, and has issued a tax exemption identification number to the Church. (Joint Ex. No. 1 ¶5)

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<sup>1</sup> The stipulations are verbatim recitations from the stipulations submitted.

<sup>2</sup> Under the provision for corporations organized for the exclusive purpose of holding title to property for an organization exempt under Section 501. 26 U.S.C.A. §501(c)(2).

6. The Taxpayer owns fee title to the property on the northeast corner of Sixth and Capitol Streets in Anywhere, Illinois, which the Taxpayer improved with a newly constructed three-floor office building. This property is legally described as “the West 140 feet of Lots 7, 10 and 11 of the South Half of Block 1 of E. Iles Addition to the City of Anywhere. (Joint Ex. No. 1 ¶6)

7. The Taxpayer acquired title to the foregoing property from The First Presbyterian Church of Anywhere, Illinois and the property, and income therefrom, are the sole assets of the Taxpayer. (Joint Ex. No. 1 ¶7)

8. The three-floor office building was built to the specifications of the United States Government, exclusively to house the offices of the United States Attorney for the Central District of Illinois, and upon completion of the construction of the building, the Government took full occupancy of the building. (Joint Ex. No. 1 ¶8)

9. The Government’s occupancy is based on a written, fifteen-year lease to the General Services Administration (GSA) of the United States Government for the purpose of housing the offices of the United States Attorney. (Joint Ex. No. 1 ¶9)

10. The lease was signed on November 13, 2001, and construction began immediately thereafter. Construction was substantially completed and the Government took full occupancy on November 26, 2002. (Joint Ex. No. 1 ¶10)

11. The lease to the GSA was specifically negotiated so that the Government’s rent payments would cover, over the fifteen-year lease term, all of the Taxpayer’s costs incurred in the construction and lease of the building, including without limitation all materials, labor, financing, taxes, maintenance, and lessor-provided services. (Joint Ex. No. 1 ¶11)

12. All excess income from the Government's rent payments is used solely in furtherance of the Taxpayer's purpose of supporting the facilities, programs and services of The First Presbyterian Church of Anywhere, Illinois. (Joint Ex. No. 1 ¶12)

13. The Taxpayer purchased materials for the construction of the office building which were incorporated into the real estate. None of the materials were subject to the lease described herein, or to any lease, until they became incorporated into the real estate. In February, 2002, the Taxpayer directed a letter to the Illinois Department of Revenue, Sales Tax Exemption Section, seeking exemption from sales tax on the purchase of these materials. (Joint Ex. No. 1 ¶13)

14. In response to the Taxpayer's application for sales tax exemption, the Department issued a notice of denial of sales tax exemption on May 24, 2002. The Taxpayer then sought a second review in accordance with Department regulations, on June 11, 2002. This resulted in the Department issuing a second notice of denial, on July 30, 2002. (Joint Ex. No.1 ¶14)

15. On August 1, 2002, the Taxpayer filed a timely protest and requested a formal hearing, claiming that the Department failed to consider the applicability of exemption based on the fact that the materials in question were for the purpose of a building leased to the United States Government. (Joint Ex. No.1 ¶15)

16. The Taxpayer withdrew its protest by letter dated December 18, 2002, but reinstated the same by letter dated January 22, 2003, after the Taxpayer learned that the Department would not recognize an exemption for the materials under 35 ILCS 120/2-5(11) and (29), and 86 Ill.Admin.Code §130.2075. On January 23, 2003, the Department reopened the matter for hearing. (Joint Ex. No. 1 ¶16)

### Additional Findings of Fact

17. Taxpayer used XXX Construction Company or its building corporation<sup>3</sup> to construct an improvement on the property to the specifications of the United States of America (hereinafter the “Government”) contract. (Dept. Group Ex. No. 1)

18. The improvement is a three-story building of 43,600 square feet of rentable space with twenty-two interior parking spaces on the first floor. The rentable space yields 30,000 to 32,000 occupiable square feet of space. The Government has exclusive use of the entire building. (Dept. Ex. No. 1; Taxpayer’s Ex. No. 6)

19. The term of the fifteen (15) year contract between the Taxpayer and GSA is from March 1, 2003, the time of substantial completion according to the contract, to February 28, 2018, subject to termination and renewal rights. (Taxpayer Ex. No. 6)

20. The Government shall pay the lessor annual rent of \$1,199,000 at the rate of \$99,916.66 per month “in arrears.” As part of the rental consideration, lessor shall furnish services, utilities, maintenance of systems, space improvements, with the exception of janitorial services and electricity and gas utilities, as enumerated in the contract. The Government makes separate payments for gas and electricity for the operation of the facility. The annual rent does not include consideration for real estate taxes. (Taxpayer Ex. No. 6)

### **CONCLUSIONS OF LAW:**

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<sup>3</sup> The contract with the construction company was not provided. The letter, dated May 15, 2002, referring to this arrangement was submitted in response to correspondence from the Department dated April 4, 2002. The letter states: “On November 13, 2001, ABC entered into a U.S. Government Lease for Real Property with the United States of America. . . . The lease covers the above described real property, together with the improvement obligated to be constructed thereon, to the specifications of the United States, by ABC using XXX Construction Company or its building corporation unit to render total rentable square feet of 43,000 on three floors with twenty-two interior parking spaces on the first floor.” (Dept. Group Ex. No. 1 p. 8)

Taxpayer has requested an exemption number so that it can purchase tangible personal property at retail without incurring ROT. It requests the number asserting that it is appropriate to grant one under 35 **ILCS** 120/2-5(11), under 35 **ILCS** 120/2-5(29), or in the alternative under 86 Admin. Code ch. I §130.2075. Taxpayer is a corporation whose sole asset is property it was deeded by a special warranty deed from the First Presbyterian Church of Anywhere on November 1, 2001. Taxpayer then used XXX Construction Company or its affiliate to erect a 43,600 square-foot three-story building on the property in conformance with the specifications in the contract between Taxpayer and GSA. Taxpayer on March 1, 2003 commenced leasing the building to the Government for \$1,199,000 annual rent payable in monthly installments of \$99,916.66.

The mechanism in the Illinois statutes for procurement of an exemption identification number for ROT purposes is found at 35 **ILCS** 120/1g, entitled “Exemption identification number.” That section of the statutes states: “On or before December 31, 1986, except as hereinafter provided, each entity otherwise eligible under exemption (11) of Section 2-5 of this Act and on and after the effective date of this amendatory Act of the 92<sup>nd</sup> General Assembly each entity otherwise eligible under exemption (9)<sup>4</sup> of Section 2-5 of this Act shall make application to the Department for an exemption identification number.” Exemption eleven (11) of section 2-5 of the ROTA (35 **ILCS** 120/2-5 (11)) states:

§ 2-5. Exemptions. Gross receipts from proceeds from the sale of the following tangible personal property are exempt from the tax imposed by this Act:

\* \* \*

(11) Personal property sold to a governmental body, to a corporation, society, association, foundation, or institution organized and operated

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<sup>4</sup> Exemption (9) deals with personal property sold to a not-for-profit music or dramatic art organization and is not relevant.

exclusively for charitable, religious, or educational purposes, or to a not-for-profit corporation, society, association, foundation, institution, or organization that has no compensated officers or employees and that is organized and operated primarily for the recreation of persons 55 years of age or older. A limited liability company may qualify for the exemption under this paragraph only if the limited liability company is organized and operated exclusively for educational purposes. On and after July 1, 1987, however, no entity otherwise eligible for this exemption shall make tax-free purchases unless it has an active identification number issued by the Department. (35 **ILCS** 120/2-5(11)).

Therefore, the only way that Taxpayer can qualify for an exemption number pursuant to this provision is if it is a governmental body, a charitable, religious or educational entity, or a not-for-profit entity that is organized and operated primarily for the recreation of persons age 55 or older. In addition, a taxpayer must have an active exemption number at the time it purchases the tangible personal property.

The ROTA imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 **ILCS** 120/2. A “‘sale at retail’ means any transfer of the ownership or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property to the extent not first subjected to a use for which it was purchased, for valuable consideration: . . .” 35 **ILCS** 120/1. The Use Tax Act imposes a tax on the privilege of using in this State tangible personal property purchased at retail from a retailer. 35 **ILCS** 105/3.

Taxpayer first asserts that the statute at 35 **ILCS** 120/2-5(11) provides an exemption from sales tax of personal property sold at retail to a governmental body, religious or charitable organization. That is a true statement; however, no where in the stipulations or record can I find a scintilla of evidence that Taxpayer is a governmental body, religious or charitable organization. Taxpayer owns fee title to real property it leases to a governmental body for an annual rent of \$1,199,000.

Taxpayer’s sole asset is the property and building leased to GSA for the purpose of housing the offices of the United States Attorney. Taxpayer’s sole member is The First

Presbyterian Church of Anywhere, a religious organization. It is well settled in Illinois that the character and purpose, for which a corporation is organized, must be ascertained from its articles of incorporation. People v. Wyanett Light Co., 306 Ill. 377 (1922), and also, Rotary International v. Paschen, 14 Ill.2d 480 (1958). Applicant's articles of incorporation provide that it is organized for the purpose of developing and increasing the facilities, programs and services of the First Presbyterian Church of Anywhere. Taxpayer's 501(c)(2) designation and its articles of incorporation establish that the Taxpayer itself is not the religious organization.

Taxpayer has also not established that it is a charitable organization under Illinois law. "A charitable purpose refers to almost anything which promotes the well-being of society and is not forbidden by law. To qualify as a charity, the purchaser must be organized and operated to benefit an indefinite number of people; there may be restrictions on the group benefited, but the service rendered to those eligible must act to relieve the public of an obligation, moral or economic, which it would otherwise have to such beneficiaries or it must confer some general benefit onto the public." Gas Research Institute v. Department of Revenue, 154 Ill.App.3d 430, 435 (1<sup>st</sup> Dist. 1987). There is nothing in the record to show that Taxpayer's leasing the building to the Government relieves the public of an obligation or confers some general benefit to the public.

In Wyndemere Retirement Community v. Department of Revenue, 274 Ill.App.3d 455 (2<sup>nd</sup> Dist. 1995, *rehearing denied, leave to appeal denied* 164 Ill.2d 585) the appellate court found it appropriate to adopt the guidelines set forth in Methodist Old Peoples Home v. Korzen, 39 Ill.2d 149, 156 (1968), a property tax exemption case, to a sales tax exemption request. The court found that the substantial fees charged by Wyndemere, the fact that it did not derive its funds mainly from public and private charity, and the fact that obstacles were placed in the way of those seeking charitable benefits precluded the court from granting Wyndemere a sales tax exemption as a charitable organization.

In this case Taxpayer's funds are not derived from public or private charity. In fact, Taxpayer is a lessor of an office building to a governmental body and all of its cost except for



real estate taxes, is covered by its lease. All of Taxpayer's funds are derived from a commercial transaction that is a leasing of real property. Taxpayer, itself, does not confer any charity and nothing in its organizational documents or its own activities causes one to conclude that it should qualify as a charitable organization under Illinois law. Taxpayer has not established that it is a charitable organization.

The well-settled law in Illinois regarding taxation exemption is that a statute granting exemption must be strictly construed in favor of taxation and against exemption. Wyndemere Retirement Community v. Department of Revenue, *supra*. Further, the exemption claimant has the burden of proving its entitlement clearly and conclusively (*id.*) with all facts construed and debatable questions resolved in favor of taxation. *Id.* Taxpayer has the burden of proving that it is entitled to an exemption, and it has not shown that it is a religious or charitable organization or a governmental body. Therefore, its argument that it is entitled to an exemption under 35 ILCS 120/2-5 (11) fails.

Taxpayer's next argument is that 35 ILCS 120/2-5(29) is applicable in this situation to afford Taxpayer an exemption on the building materials that it purchased to construct the three-floor office building. Section 120/2-5 (29) provides an exemption from sales tax of personal property sold to a lessor who leases the property to a governmental body for at least one year. Taxpayer argues that this section must be read *in para materia* with 35 ILCS 120/2-5(11) and, when so read, it is entitled to an exemption letter and number. Taxpayer also asserts that the exemption provisions should be broadly construed. It argues that this case falls within the intent of this particular exemption provision. (Taxpayer's brief pp. 7-10).

Taxpayer's argument fails because personal property is not what it is leasing to the governmental body for one year or longer. Taxpayer/lessor is leasing a three-story building that houses the offices of the United States Attorney. The court in G S. Lyon & Sons Lumber and Manufacturing Company v. Department of Revenue, 23 Ill.2d 180 (1961, *reh'g denied*) discusses the fact that once building materials are incorporated into an edifice, the materials are no longer tangible personal property and instead become real estate:

We think it is clear, as the Department points out, that where the material is used in constructing a house on land owned by the builder, the one who sells materials to him incurs the tax even though the builder intends to sell the house after it is completed. To take the initial sale out of the category of retail sales within the meaning of the act it is necessary that the contemplated resale be a sale of the property in its form ‘as tangible personal property.’ It is obvious that building materials, after they have been used in the construction of a house, constitute real estate rather than personal property, and they are not transferred to the homeowner in any form as tangible personal property when the house is subsequently sold. The sale of materials to the builder, therefore, is not for resale in any form as tangible personal property. . . *Id.* at 182-83

Therefore, the building materials used in the construction of this building constitute real estate under the lease. Taxpayer is correct that tax exemption statutes should not be given unreasonably narrow constructions, Southern Illinois University v. Booker, 98 Ill. App. 3d 1062, 174 (5<sup>th</sup> Dist. 1981), Weslin Properties v. Dept. of Revenue, 157 Ill. App. 3d 580, 584 (2<sup>nd</sup> Dist. 1987), however, Weslin clearly recognizes and accepts what is well established Illinois law when it provides:

that “statutes granting tax exemptions must be strictly construed in favor of taxation [citation], and the party claiming an exemption has the burden of proving clearly and conclusively that the property in question falls within both the constitutional authorization and the terms of the [exempting] statute \* \* \* [citations].” (Board of Certified Safety Professionals of the Americas, Inc. v. Johnson (1986), 112 Ill. 2d 542, 547, 98 Ill.Dec. 363, 494 N.E.2d 485.) Moreover, all facts are to be construed and all debatable questions resolved in favor of taxation. (Methodist Old Peoples Home v. Korzen, (1986), 39 Ill. 2d 149, 155, 233 N.E.2d 537.) Weslin at 584.

Therefore Taxpayer cannot qualify for exemption under 35 **ILCS** 120/2-5(29) because it is not leasing personal property, but rather, it is leasing real estate to the Government and it has not met its burden of proving clearly and convincingly that it is entitled to the exemption under that statute.

Taxpayer’s last argument is a blend of its first and second arguments with the same result. Taxpayer argues that Department regulation, 86 Ill.Admin.Code §130.2075 provides a

tax exemption for the building materials at issue. The sub-section of 86 Ill. Admin. Code ch. I Sec. 130.2075 that Taxpayer asserts is relevant states:

d) Sales of Materials to Construction Contractors Acting for Exclusively Charitable, Religious or Educational Organizations or Institutions, or for Governmental Bodies

1) Sales of materials to construction contractors for incorporation into real estate owned by exclusively charitable, religious or educational institutions or organizations, or any not-for-profit corporation, society, association, foundation, institution or organization which has no compensated officers or employees and which is organized and operated primarily for the recreation of persons 55 years of age or older, or for incorporation into real estate owned by governmental bodies, are exempt from Retailers' Occupation Tax and Use Tax. The intent of the Legislature was to relieve the above-designated kinds of purchasers from the burden of tax on their purchases whether the purchases are made directly or indirectly by these organizations. Therefore, the exemption applies to their indirect purchase of building materials. . . .

(e) Sales of Materials to Construction Contractors for Incorporation into Public Improvements Which are Required to be Transferred to a Unit of Local Government Upon Completion

For the same reason stated in subsection (d) of this Section, sales to construction contractors of materials which will be physically incorporated into public improvements, the ownership of which is required to be conveyed to a unit of local government pursuant to a pre-development transfer requirement are exempt from Retailers' Occupation Tax and Use Tax. The supplier shall have among his records the active registration number issued by the Department to the governmental unit to which the public improvements will be transferred upon completion. The pre-development transfer requirement may take the following forms:  
...

These regulations apply to personal property sold to construction contractors. It is unclear in the record that Taxpayer acted as a construction contractor. The only evidence in the record is that Taxpayer purchased the personal property for the construction of the office building. 86 Ill. Admin. Code ch. I Sec. 130.1940 defines a construction contractor to include a general contractor, subcontractor and specialized contractor. “‘Contractor’ means any person

who is engaged in the occupation of entering into and performing construction contracts for owners.” There is nothing in the record that allows Taxpayer to be defined as such. Taxpayer was formed to assist in developing and increasing the facilities, programs and services of the Church.

It also must be remembered that the Taxpayer, not the Government, owns the property. In order for the rule to apply, there must be a sale of materials to a construction contractor for incorporation into real estate that is owned by a religious, charitable, educational, governmental, or not-for-profit group organized for the recreation of persons 55 or older. Taxpayer, who owns fee title to property, does not qualify as any of these.

Taxpayer contracted with XXX Construction Company or its building corporation to build the three-story office building on the Taxpayer’s property. Therefore, there is nothing in the record to indicate that the Taxpayer is a construction contractor. Rather, Taxpayer owns the property it is leasing, for substantial sums, to a governmental body. Therefore, the rule does not apply to the Taxpayer in this situation, and it would not be legal to grant an exemption under that section.

**WHEREFORE,** for the foregoing reasons, I recommend that the Department’s denial of the exemption identification number to ABC Building Corporation be upheld.

Respectfully Submitted,

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Barbara S. Rowe  
Administrative Law Judge  
Date